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SUBJECT: THE SARG'S NEW ECONOMIC SCORECARD

REF: A. DMS 1926

¶B. DMS 1696
¶C. 05 DMS 6389
¶D. DMS 0196

¶1. (SBU) Summary: The recently enacted 10th Five-Year Plan presents a number of quantifiable targets for reaching seven percent annual GDP growth and represents an agenda for reform against which the SARG's progress can be measured. The plan assumes that broad-based reform will allow the SARG to meet its targets despite significant economic obstacles and resource constraints, but offers few specifics on how or when those reforms will be implemented. The plan, therefore, has many detractors who are less than optimistic about its chances of success. End summary.

THE SARG'S ECONOMIC SCORECARD

¶2. (SBU) President al-Asad signed into law the SARG's 10th Five-Year Plan on May 7, covering a period ostensibly from January 2006 through the end of 2010, after months of inaction and three days of Parliamentary debate. The plan establishes as a goal the gradual transformation of Syria's economy from centrally-planned to market-based, obtaining annual growth rates in GDP of five to seven percent and a resulting eight percent reduction in poverty by the end of ¶2010. Since Asad assumed power in 2000, the SARG has claimed a commitment to reform while offering few concrete obligations. Contacts who have worked on this plan defend it by pointing to the specific economic and poverty reduction targets it establishes, and its emphasis on directing resources toward Syria's most impoverished regions in the South and Northeast. Detractors point out that the SARG has yet to develop comprehensive benchmarks or the implementing details to reach the targets, and that the plan's success depends upon the SARG immediately instituting broad-based economic reforms that it so far has been unwilling to do. All agree, however, that the plan will become the SARG's scorecard on economic reform.

BENCHMARKS FOR PRIVATE INVESTMENT

¶3. (SBU) The plan's success in achieving high rates of annual GDP growth hinges on the SARG's ability to attract private sector investment. The plan estimates that Syria needs $36 billion in total investments by 2010 to reach its growth target, $17 billion from the public sector and $19 billion from the private. The plan aims to limit SARG investment

spending and support for existing or new State Owned Enterprises (SOEs) to an average 14 percent of GDP per year for five years, a relatively modest increase of two percent over the average level of government investment spending on SOEs during the previous five years. The investment goal, according to contacts, is to gradually open the economy to greater competition by supporting the private sector and attracting foreign direct investment (FDI).

¶4. (SBU) The SARG faces a number of obstacles toward achieving higher levels of private sector investment, however. Investors are plagued by a lack of access to credit, since Syria's private banks still are unwilling to increase their loans-to-deposit ratio. In addition, the SARG continues to crowd out private investment through its unwillingness to reduce public spending and support for SOEs- actually increasing its allocation for public sector investment by eight percent in the 2006 budget to $3.9 billion, or 18 percent of GDP. Further, most private investors are hesitant to increase their commitments or exposure to risk due to the poor investment climate, which is characterized by high corruption, poor contract enforcement, the lack of an independent judiciary, and the SARG's slow pace of reform. Although the plan specifically mentions steps to address these obstacles, including providing small and medium enterprises (SMEs) with greater access to loans and credit facilities through both public and private banks, and allowing foreign investors to repatriate profits, the private sector remains largely skeptical of the SARG's ability to deliver on its promises.

¶5. (SBU) New private investment is critical for the SARG to make headway on one of its most pressing economic challenges- burgeoning unemployment (ref A). The plan calls for public

and private investment to create 1.3 million new jobs by 2010 and cut the official unemployment rate of 12 percent in half. With the SARG budgeting for the creation of just over 58,000 jobs in 2006, the private sector would have to create approximately 140,000 new jobs to meet the plan's first year employment goal- four times the rate in 2005.

¶6. (SBU) Meeting these employment targets depends on the SARG's willingness to liberalize the economy. The SARG continues to be the single largest employer, and its central role in the energy and power sectors, as well as agricultural supply chains, chokes off private sector job growth in these key sectors. Although the tourism sector holds promise, most investors are moving forward cautiously with their projects as the political and economic climate remains unclear. While the plan mentions SMEs, including those with fewer than nine employees, as a possible source for Q jobs, the SARG lacks basic information on their number and aQrbtive capacity since most operate in the informal sector.

BENCHMARKS FOR REDUCED SPENDING & INCREASED REVENUE

¶7. (SBU) In seeming contradiction to its job creation goals, the plan also establishes targets for a less expansionary fiscal policy and low inflation. The plan specifies that the SARG shoQ maintain budget deficits equal to approximately three percent of GDP, down from a budgeted 9.5 percent in 2005, and sets an inflation target of five percent. In addition, the plan calls for the SARG to reduce its "current expenditures," which covers all non-investment spending including salaries and subsidies, to approximately 20 percent by 2010. Further, the plan calls for a 75 percent reduction in subsidy costs over the five-year period.

¶8. (SBU) The SARG again faces a number of obstacles related to meeting its spending targets. To meet its growth goals listed above, the SARG must be committed to increase spending to create the 58,000 new public sector jobs in 2006. Additionally, declining oil revenues will make it difficult for the SARG to maintain its deficit targets without major

fiscal reform, specifically a reduction in subsidies and price supports (ref B). The size of the obstacle also is much larger than the SARG's official numbers admit. Last year, the SARG budgeted $500 million for subsidies through its price stabilization fund, but spent approximately $4 billion on subsidies for oil products alone. This year the discrepency is expected to grow even larger.

¶9. (SBU) The plan assumes that the SARG can control deficits from the revenue side by introducing a Value Added Tax (VAT) on consumption to dramatically increase its tax receipts from a baseline of 8.7 percent of GDP in 2005 to 16 percent in ¶2010. Qeloping the tax base and other reliable sources of income is a critical fiscal issue in the face of steadily declining Q revenues. The biggest obstacle to achieving this goal is the SARG's inefficient tax system, which contacts say the government must completely modernize. In addition, it has to update its commercial registry and provide incentives, such as a reduction in income tax rates, to bring more SMEs into the formal sector. Finally, the SARG woulQave to engage in an extensive public education campaign about proper accounting practices to raise compliance rates and stop the practice in which SMEs hide profits from the tax department by keeping multiple sets of books.

BENCHMARKS FOR OIL AND GAS

¶10. (SBU) In addition to its focus on establishing alternative revenue sources, the plan seeks to direct investment toward stabilizing the rate of oil production. According to the plan, Syria must flatline its production at 350,000 barrels per day (bpd) through 2010 to achieve and sustain high growth. The SARG's ability to reach its target is predicated on its ability to bring thousands of barrels of new production on line and offset the rate of decline in its aging fields estimated to be 15 percent annually (ref C). Without new production, Syria's oil output will approach 350,000 bpd already by the end of this year.

¶11. (SBU) The plan also assumes that Syria will be able to increase its gas production from the current level of 22

million cubic meters (mcm) of gas per day, to 32 mcm/day by ¶2010. According to the plan, Syria will substitute natural gas for oil in industry and energy production domestically, thereby freeing up more oil for export. While Syria has modest proven gas reserves, approximately 13.1 trillion cubic feet (tcf), the sector needs to attract significant foreign investment to tap its reserves, increase processing capacity and convert its industrial and power generation infrastructure to run on gas at a time when established Western companies like Conoco Phillips are divesting their Syrian assets (ref D).

BENCHMARKS FOR TRADE

¶12. (SBU) The plan calls for increased private sector involvement in exports to help reduce the balance of payments deficit to 6.6 percent of GDP by 2010. The plan sets a target of increasing the value of exports to cover 80 percent of imports, based primarily on a 15 percent annual increase in private sector exports each year. According to the SARG's most recent trade statistics, exports covered approximately half of imports during the first half of 2005. The trade deficit in the private sector grew by approximately 45 percent in 2004, the last time the SARG published figures on the subject, and has shown signs of accelerating since GAFTA went into effect last year.

¶13. (SBU) In order to reverse this trend, the SARG would have to increase the efficiency and competitiveness of its export sector, and begin to provide incentives to promote export growth. For instance, the SARG would have to drop price supports for agricultural raw materials like cotton that

drive up the prices of textiles, which already face stiff competition abroad, and reduce tariffs and taxes that are levied on exports to non-Arab countries. In addition, the SARG would have to change its policy of currency support, which currently has overvalued the Syrian pound at the expense of exports, to provide long term currency stability. Finally, ceasing its support for inefficient SOEs also would help the export sector grow, where overemployment, waste, corruption, and near monopoly control over the supply chains make locally-produced goods for export uncompetitive in quality or price.

¶14. (SBU) Comment: The optimists among our contacts view the 10th Five-Year Plan as Syria's first step, despite its imperfections, toward a market economy. Most interlocutors, however, claim that unrealistic assumptions, formidable obstacles, and lack of specific details for implementation will keep it from being the reform agenda that Syria needs. Everyone agrees, however, that the plan is hugely ambitious and would require significant effort and political will to have any chance of implementation. The SARG's efforts in this regard are not off to a very auspicious start, squandering the first five months of the plan to get it ratified and signed, which is arguably the easist part.
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